BEFORE THE
UNITED STATES DEPARTMENT OF AGRICULTURE
WASHINGTON, D.C.

PUBLIC COMMENTS TO ASSESS THE)
FUTURE OF MILK MARKETING ORDERS)

COMMENTS OF THE DEPARTMENT OF JUSTICE

James F. Rill
Assistant Attorney General
Antitrust Division

J. Mark Gidley
Acting Deputy Assistant
Attorney General
Antitrust Division

Janusz Ordover
Deputy Assistant
Attorney General
Antitrust Division

Mark C. Schechter
Chief
Transportation, Energy and
Agriculture Section

Roger W. Fones
Assistant Chief
Transportation, Energy and
Agriculture Section

Susan L. Edelheit
Janet R. Urban
Attorneys
Transportation, Energy and
Agriculture Section
Antitrust Division
Department of Justice
555 4th St. N.W.
Washington, D.C. 20001
(202) 307-6349

March 6, 1992

BEFORE THE
UNITED STATES DEPARTMENT OF AGRICULTURE
WASHINGTON, D.C.

PUBLIC COMMENTS TO ASSESS THE)
FUTURE OF MILK MARKETING ORDERS)

COMMENTS OF THE DEPARTMENT OF JUSTICE

INTRODUCTION

The United States Department of Justice ("Department") respectfully submits these comments to urge the United States Department of Agriculture ("USDA") to terminate the milk marketing order program. The Department welcomes USDA's invitation, issued by Secretary Madigan in a press release on November 15, 1991, for the dairy industry and the general public to assess the future of the marketing orders. The time has come to move decisively toward elimination of this arcane system of regulation. Based on USDA's own estimates, this outdated and inefficient system now costs society approximately $1 billion each year, and the cost may in fact be more.1/ Milk marketing, like virtually all other industries, should be

---

1/ As discussed infra at p. 11, a study by USDA's Economic Research Service found that society would enjoy efficiency gains of approximately $1 billion each year if milk price regulation were eliminated. This cost estimate does not include any savings that would result from use of milk reconstituted from dry milk powder or, as discussed infra on p. 16, from eliminating excess production of Grade A milk.

allowed to operate in a free market. This will lower industry costs, result in a sounder dairy industry, and provide consumers with a dependable supply of milk in a more efficient and competitive way.

The detailed and complex regulatory structure that controls the marketing of milk in the United States illustrates the difficulties inherent in the regulation of what would otherwise be a well-functioning competitive marketplace. Markets that are inherently competitive are generally more difficult to regulate than markets that are monopolistic. Regulators must gather and analyze an enormous amount of information to reach decisions that would be made automatically by the price system. Competing firms then react to these regulatory decisions in ways that require even more detailed regulations in order to maintain the "integrity" of the regulatory system. As the regulatory system becomes more complex, it becomes less able to adjust to changing economic circumstances. Thus, the distortions and inefficiencies associated with the regulatory system tend to expand greatly over time.

Our nation's experience amply demonstrates that free markets best determine optimal production and price levels, allocating our Nation's resources to the benefit both of efficient

producers and consumers. Regulation should be substituted for a free market only where exceptional circumstances -- known as externalities or market failures -- exist and where the costs of regulation do not exceed its benefits. See generally Economic Report of the President, February 1992, Chapter 5, and Regulatory Program of the United States Government, Appendix V. There are no such exceptional circumstances present in the milk industry, and the pervasive system of regulation is now both unnecessary and costly.

The marketing order system is designed to address conditions that ceased to exist long ago. The system no longer meets the goals of the Agricultural Marketing Agreement Act ("AMAA"), enacted in 1937 -- to improve the plight of the dairy farmer by avoiding unreasonable fluctuations in supplies and prices and to assure an adequate supply of fluid milk. Instead, it now hinders accomplishment of those goals and imposes significant costs on consumers, producers and taxpayers.

Current milk market regulation promotes high-cost production at the expense of low-cost producers by establishing high regulated prices and keeping reconstituted milk off the market. Farmers in high-cost regions are insulated from competition from milk reconstituted from concentrated ingredients produced in

low-cost regions, while farmers who can produce milk at a low cost are unable to reap the full competitive benefits of their efficiency.

Those features of the marketing order system that prop up high-cost production do so at an excessive cost both to milk consumers and to society as a whole. High regulated prices and the current effective ban on reconstituted milk force consumers to pay more for fresh fluid milk than they would pay in a free market. Consumers are now deprived of the opportunity to purchase reconstituted milk, a high quality fluid product that in many regions might otherwise be sold at a price competitive with that of fresh milk. The system also causes excess production which is subsidized by taxpayers. Regulated prices that are higher than they would be in a free market encourage farmers to produce too much milk; the excess is made into unneeded dairy products that the government is forced to buy.2/

2/ In 1986, the government spent more than $2 billion to purchase surplus dairy products under the dairy price support program. Milk Marketing Orders, Options for Changes, United States Government Accounting Office (1988) at 14.

The USDA should commit to full elimination of the antiquated marketing order system.3/ Elimination of the orders would improve performance in the dairy industry and lower milk prices to consumers.

I. Background

The milk marketing order system is one of the most extreme forms of government control of agriculture in this country and imposes substantial net costs on society. The regulatory system as a whole causes consumers to pay higher than necessary prices for fluid milk, while at the same time encouraging excess production that must be purchased by the government at the

---

3/ The USDA recently held a national proceeding to consider changes in the milk marketing order system ("national proceeding"). In that proceeding, the Department proposed reforms -- eliminating entirely the regulatory barriers to use of reconstituted milk and significantly lowering regulated prices -- that would constitute an important move towards eventual elimination of the marketing order system. During the course of the lengthy hearing, no party presented any facts or proferred any argument that undermined the conclusion that the USDA can and should adopt these proposals. In its Recommended Decision in that proceeding, 56 Fed.Reg. 58972 (1991), the USDA proposed changes that would ease regulatory restraints in the treatment of reconstituted milk but would still subject reconstituted milk to a pricing system that discourages its use by artificially raising its price. In these comments, we cite to the transcript of the hearings held in that proceeding.

taxpayers' expense.4/ The down allocation and compensatory payment provisions, by eliminating the economic incentive to use reconstituted milk,5/ keep fluid milk products off the market that would lower costs to the industry and consumers and promote market stability.

Current milk regulation encompasses a system of orders, each order representing a separate geographic area. Each order sets minimum prices that a regulated milk processor ("handler") must pay for milk, based upon the way the milk is used. Grade A milk used for fluid purposes is Class I and has the highest price. Milk used for manufacturing purposes is assigned the lowest (usually Class III) value. Each handler pays into a pool an amount which equals the total milk used in each class multiplied by the class price. The producers receive a "blend price" from the pool which equals the average value of the milk that was pooled.

The order system is based on the Upper Midwest marketing

4/ The Agricultural Act of 1949, 7 U.S.C. § 1421 et seq., requires the government to purchase at a set price offered farm commodities, including manufactured dairy products, which meet statutory specifications. In 1986, the government spent more than $2 billion to purchase surplus dairy products.

5/ See infra, p. 7 for a description of the down allocation and compensatory payment provisions.

order. That order sets the Class I price at the market-determined price for milk that is not Grade A, plus a differential ("the Grade A differential") that was intended to reflect only the added cost of meeting higher sanitation standards for fluid milk, but is in fact now artificially inflated.6/ To set Class I prices in the nation's 41 other marketing order areas, distance differentials are added to the Class I price in the Upper Midwest Order. These distance differentials cause the price of Class I milk in some markets to be higher than the free market price.7/ In these markets, the differentials raise prices to consumers, suppress consumption, and create a regulatory incentive for farmers to produce too much milk; the excess is made into unneeded dairy products that the government is forced to buy under the price support program.8/

Most orders now contain down allocation and compensatory payment provisions which are applied to milk reconstituted from fluid concentrate or powder. These provisions effectively require a reconstituting handler to pay the equivalent of the

---

6/ See discussion at pps. 15-16.

7/ The distance differential is intended to reflect shipping costs from Eau Claire, which are not necessarily related to local production costs.

8/ See discussion at pps. 12-15.

local Class I price on the milk that has been reconstituted.9/ These regulations eliminate any cost advantage a handler could achieve by purchasing concentrate or powder from surplus production regions. When the further costs of transporting the concentrate (or powder) and reconstituting it into fluid are added, the cost of reconstituted milk is inflated beyond the cost of local or imported fresh fluid milk. The market, not regulation, should determine whether reconstituted milk would be offered for sale and at what price.

II. The Conditions Leading to the Enactment of the AMAA No Longer Exist

Conditions have dramatically changed since the AMAA was enacted during the Depression to assure an adequate and dependable supply of milk, 7 U.S.C. § 608c(18) (Supp. 1990), maintain "orderly marketing conditions," and improve the plight of the farmer by avoiding unreasonable fluctuations in supplies and prices. 7 U.S.C. § 601, § 602(4) (1980 & Supp. 1990). Then, because refrigeration and roads were poor, processors could procure milk from only a few nearby markets. Jesse 9/12 Transcript ("Tr.") at 35. Under the circumstances, it is not surprising that the regulatory system developed in a way that protected

---

9/ The down allocation or compensatory payment to the local order is generally equal to the difference between the Class I price in the handler's own order and the Class III price (which is the same in all marketing orders).

local production. Jesse 9/12 Tr. at 34. Since milk could not be moved long distances, there would not be enough milk available to consumers if local production were inadequate.

Today, over 50 years later, the 1930s rationale for pervasive regulation has been completely undermined by modern technology and resulting economic changes. Kimmel Exhibit ("Ex.") 211 at 3. First, fluid milk can now be made less bulky and thus more easily transportable by removing water and converting it into fluid concentrate or dry milk powder to be reconstituted after shipment. Fluid milk can also be made less perishable because powder can be stored for significant periods of time. Second, improved refrigeration, which has increased the shelf life of fluid milk, and the growth of the federal highway system, allows even bulky and perishable fluid milk to be moved long distances to serve dispersed markets. Jesse 9/12 Tr. at 35; Kimmel Ex. 211 at 12. As a result, markets for bulk milk are no longer necessarily local in nature. Jesse 9/12 Tr. at 79-80. Bulk milk can now be hauled more than a thousand miles without deterioration. Jesse 9/12 Tr. at 35. It is not unusual for milk to move 200-300 miles within a market, and more than 1000 miles from surplus to deficit areas. Christ 11/2 Tr. at 155. The electrification of rural areas and the proliferation of telecommunications have also significantly decreased the isolation of the farmer and made it practical for him to deal with distant markets.

The marketing position of dairy farmers is also wholly different than it was in the 1930s. The vast majority of dairy farmers now belong to dairy cooperatives, large organizations that market the milk of their members and bargain on their behalf with processing plants. In 1987, approximately 90% of all dairy farms in the United States belonged to cooperatives; these cooperatives received 76% of all milk delivered to processing plants and dealers in the United States. Marketing Operations of Dairy Cooperatives 1989, USDA, pps. iv, 17, 27; 1987 Census of Agriculture. In contrast, only about 10% of United States milk production was marketed through cooperatives in 1929-33.10/ Large cooperatives dominate this landscape; in 1987, more than half of United States milk production was handled by only twenty cooperatives. Marketing Operations of Dairy Cooperatives 1989, USDA, p. 30.

The seasonality of milk production, also cited as a justification for regulation, has decreased significantly since the enactment of the AMAA. While production in the peak month exceeded production in the low month by about 50% or more until 1955, this disparity has fallen sharply and was only 12% by 1981. Kimmel Ex. 211 at 7. From 1986 to 1988 no month's daily average milk production differed from the annual daily average

---

10/ Manchester, The Public Role in the Dairy Economy, pps. 21-22.

by more than 10%. Id.11/ Moreover, any seasonal imbalances in supply that remain can now be redressed through the use of dry milk powder. Powder can be made from milk produced in the spring, stored and then reconstituted into fluid when needed in the fall.

III. The Milk Marketing Order System Imposes Substantial Costs And Is Inefficient

A recent study by USDA's own Economic Research Service ("ERS") found that if milk price regulation were eliminated, even while maintaining a ban on reconstituted milk, society would enjoy efficiency gains of approximately $1 billion each year. Federal Milk Marketing Orders: An Analysis of Alternative Policies, 1988, at 30. These efficiency gains would stem from, among other things, increased consumption of fluid milk due to lower prices, and reduction of excess production now caused by artificially high blend prices. Kimmel Ex. 211 at 6.12/ The study also found that using milk reconstituted from

---

11/ While the variation in production was much higher in 1989 than in previous years, that variation was due to exceptional weather rather than seasonality. See O'Brien 11/8 Tr. at 169. Even the variation in 1989 was only a fraction of the regular seasonal variation of the period before 1955. Kimmel Ex. 211 at 7.

12/ The ERS noted that these efficiency gains could be less if market risk and uncertainty increased in the absence of price regulation. Federal Milk Marketing Orders: An Analysis of Alternative Policies, 1988, at 22. However, as discussed below, market risk and uncertainty should actually decrease under deregulation, particularly because the use of reconstituted milk would be feasible.

concentrated fluid by itself would save society at least $183 million per year. Federal Milk Marketing Orders: An Analysis of Alternative Policies, 1988, at 30.13/

A. High Distance Differentials, Coupled With The Current Effective Ban On Reconstituted Milk, Raise Prices to Consumers and Cause Inefficient Production

Distance differentials now cause the Class I price in some areas to be higher than the free market price. Kimmel Ex. 211 at 24; see also Jesse 9/12 Tr. at 26; Haldeman 11/2 Tr. at 218. In these areas, consumers pay higher than appropriate prices, which causes artificially low consumption. Kimmel Ex. 211 at 24. Consumers would benefit from lowered differentials -- prices would be reduced and they could consume more milk.14/

In areas where Class I prices are now less than the free market price, terminating the order system would have no detrimental effect: The only difference is that market price levels would completely reflect market conditions, whereas under regulation over-order premiums were used to raise prices to

---

13/ Since this ERS study did not consider the use of powder, total cost savings from use of reconstituted milk should be even greater.

14/ An example of the increased consumption of milk is the experience in South Carolina. See discussion at pp. 26-27.

competitive levels.15/ Cf. Kimmel Ex. 211 at 24; Jesse 10/17 Tr. at 158. Similarly, market prices also ensure that shortages would not occur in a deregulated environment. The free market price in a particular area would rise to levels sufficient to encourage production of enough fluid milk to meet demand, and would increase until production reached adequate levels. Cf. Kimmel Ex. 211 at 25.

In areas where Class I prices are higher than free market prices, farmers are encouraged to produce too much milk.16/ Kimmel Ex. 211 at 25-26; Christ 10/23 Tr. at 17-18. The government, under the current price support program, then must purchase excess manufactured products at taxpayers' expense. Currently, high order system differentials encourage production beyond fluid needs even in high-cost areas, and manufactured products are produced in these regions. Kimmel Ex. 211 at 26-7; Gunderson 9/5 Tr. at 78-9; Haldeman 11/2 Tr. at 217-8. This is inefficient since manufactured products can be more

---

15/ An over-order premium is a payment above the regulated price. Over-order premiums already exist in most markets. Jesse 9/17 Tr. at 83.

16/ A farmer in a region with high Class I prices -- and, thus, high blend prices -- has the incentive to continue producing milk until his incremental costs rise to the high price he receives. Thus, in such a region, even a farmer whose costs are initially low will continue producing milk until his costs are high. Kimmel, Ex. 211 at 25-26.

cheaply produced in low-cost areas and shipped inexpensively to consumers anywhere in the country. Kimmel Ex. 211 at 25-6. Removing the regulatory incentives to produce excess milk in high-cost areas would replace high-cost production with low-cost production, and eliminate some surplus production of manufactured products. Kimmel Ex. 211 at 25-6; Jesse 10/17 Tr. at 158.

Two examples of the inefficiency induced by distance differentials are provided by the Southwest Plains Milk Marketing Order and the New York-New Jersey Milk Marketing Order. Both orders utilize most of their milk in manufactured products even though their milk prices, and their costs of producing additional milk, are substantially higher than prices and costs in the Upper Midwest Milk Marketing Order. Federal Milk Order Market Statistics, 1989 Annual Summary, Ex. 7, at 46-7. If the order system were eliminated, regulated distance differentials would disappear, and farmers in these regions would have less of an incentive to produce high-cost milk for manufactured products.

The down allocation and compensatory payment provisions, which currently make reconstituted milk more costly than local supplies, also erect a trade barrier to the flow of concentrated milk produced in less expensive areas. These barriers to the production and sale of low-cost milk work together with high Class I prices to keep milk prices unnecessarily high in many

regions. Jesse 9/12 Tr. at 26; Haldeman 11/2 Tr. at 215. The high Class I prices in markets distant from the upper midwest and the effective ban on reconstituted milk insulate local markets from competition and "erect ... barriers to efficient milk movement. . . ." Jesse 9/12 Tr. at 26.

B. The Grade A Differential Creates Incentives For Wasteful Production Of Grade A Milk

The Class I differential in the Upper Midwest Order, known as the Grade A differential, was established to encourage handlers to upgrade their equipment to meet the sanitary standards necessary for fluid milk. Milk Marketing Orders, Options for Changes, United States Government Accounting Office (1988) ("GAO Report") at 25. The differential is now set too high, and encourages handlers to meet Grade A standards when, in fact, the milk they produce is consumed in ways that do not benefit from that special handling. Christ 9/18 Tr. at 116.17/ As a consequence, too much Grade A milk is produced. Gunderson 9/5 Tr. at 71-2.

The amount of wasteful utilization of Grade A milk is extensive. Although only 40% of the milk produced in this country is consumed in fluid form, 90% of the milk is produced

---

17/ See also GAO Report at 26. The Government Accounting Office found that the Class I price was higher than needed to attract a sufficient amount of Grade A milk.

to meet fluid grade standards. Kimmel Ex. 211 at 27; Christ 9/18 Tr. at 123. Since only 10% of total fluid production is needed for fluid reserves,18/ fully 40% of total milk production unnecessarily meets Grade A standards.

The potential cost of this waste is significant. The American Agricultural Economics Association Task Force on Dairy Marketing Orders reported estimates of the extra cost of meeting Grade A standards ranging from 0 to 50¢ per hundredweight and concluded that the actual cost is 15¢ per hundredweight or less. Ex. 39, Federal Milk Marketing Orders: A Review of Research on Their Economic Consequences, at 19. At annual milk sales of approximately 1.42 billion hundredweight, wasted costs of 15¢ per hundredweight on 40% of that milk would result in an annual waste of over $80 million. Kimmel Ex. 211 at 27.

IV. Reliance On The Free Market Would Provide More Orderly Marketing Than the Current Regulatory System

Reliance on the free market, including elimination of regulatory barriers to the use of reconstituted milk, would meet the goals of the AMAA more efficiently than the extensive regulation now in place. The ability to ship a product from one

---

18/ A reserve of 25% of fluid consumption is a sufficient reserve. Lamers 9/12 Tr. at 230; Jesse 9/17 Tr. at 136; Weisser 10/5 Tr. at 91. Since 40% of total milk production is consumed in fluid form, 10% of total production (i.e., 25% of 40%) would provide the needed fluid milk reserve.

area to another promotes market stability by reducing dependence on particular sources of supply. Product storage also provides stability by allowing producers to smooth out seasonal or other imbalances in supply. Use of other free market approaches, such as long term supply contracts, could also stabilize the industry. Finally, the experience of deregulated milk markets suggests that deregulation has produced benefits without adverse effects.

A. Storage, Shipment, and Other Free Market Approaches Provide Market Stability

The market has developed responses that reduce or avoid disruptions of the orderly flow of goods. These market responses are superior to regulatory responses because the market can move rapidly when an unexpected situation occurs.

Unlike the situation when the AAMA was enacted, interregional shipment and improved storage now provide excellent means for the market to respond to potential or actual market disruption. Inter-regional shipment stabilizes markets by allowing products to be moved from areas where production costs are lower to areas where they are higher. These shipments also allow milk movement from areas with excess production to regions that are suffering from shortfalls. Kimmel Ex. 211 at 11; Jesse 9/17 Tr. at 149. Shipments also increase stability because of the "law of large numbers": The greater the number of independent producing regions the greater the chance that a

shortfall or excess in one region will be balanced by the opposite occurrence in another region. Kimmel Ex. 211 at 12. Thus, as the ability to ship a product combines otherwise isolated market areas into broader integrated market areas, the occurrence of a shortfall or excess in any one market becomes less significant. Id.

Storage is particularly effective in smoothing out seasonal variations in supply and demand. Crops, or other products, are stored during times of high production and shipped where they are needed during times of low production. Kimmel Ex. 211 at 9. The ability to store and ship products not only smooths out normal seasonal variations, but also provides stability at times of unexpected, larger than normal variations. Significant surpluses could put an enormous downward pressure on prices if all of the product had to be consumed at the time it was produced. Kimmel Ex. 211 at 9. However, if consumption could be delayed by storing the product, the pressure to reduce prices would not be so great. Id. Similarly, if stored product is available when production is unexpectedly decreased, for example because of bad weather or disease, the upward pressure on prices will not be as great. Id.

Shipment of fluid milk to distant points is expensive, and fluid milk cannot be stored for long periods. A more economical method of long distance transportation is to ship the milk after

some or all the water has been removed, as fluid concentrate or powder. Nonfat dry milk powder can also be stored until it is needed during a time of lower production. Use of reconstituted milk would stabilize milk markets by smoothing out the normal seasonality that occurs between the high production season in the spring and the low production season in the fall, Williams 9/10 Tr. at 143; Jesse 9/17 Tr. at 97, as well as unexpected variations in production. Kimmel 11/15 Tr. at 295-296.

To the extent that milk marketing retains some seasonal characteristics, it is not unlike other industries, agricultural and non-agricultural, in which supply and demand vary with the season or business cycle. Kimmel Ex. 211 at 8. Such industries employ many different free market approaches to deal with seasonal fluctuations in supply and demand, many of which are equally available to dairy farmers. Id. For example, dairy farmers could enter into long-term, full supply contracts, giving them assured outlets for their production. Kimmel 11/15 Tr. at 340. Such contracts could be formulated in a manner to take into account characteristics of the milk industry.

1. The Use Of Reconstituted Milk Would Stabilize The Market

Greater use of milk reconstituted from powder and fluid concentrates would efficiently solve the very problems that marketing orders were designed to remedy. The marketing order

system, with its reliance on and preservation of local markets, has been justified on the basis of milk's bulk and perishability. However, reconstituted milk solves both of these problems. Fluid and dry concentrate are far less bulky and thus much cheaper to ship, and powder can be stored for long periods of time.

As transportation costs are reduced through the shipment of concentrates, the size of local markets will likely increase. There will be greater reliance on shipments -- from a broader geographic area -- to satisfy local demand. As discussed earlier, this stabilizes markets by reducing dependence on particular production sources. Powder, because it is less expensive to ship, will widen markets further because more shipments will be brought in from more regions.

Powder also holds the unique advantage of storage which also promotes price stability. Powder can be made from milk produced during the spring flush season, stored, and then reconstituted into fluid during the fall, when supplies are short. Haldeman 11/2 Tr. at 213-14, 216. This would help smooth out seasonal, as well as regional, supply imbalances. Kimmel Ex. 211 at 20.

Storing powder for subsequent reconstitution when supplies are short would also reduce seasonal shifts in price. Williams 9/10 Tr. at 143, 195; Jesse 9/17 Tr. at 97; Kimmel Ex. 211, at

21; Haldeman 11/2 Tr. at 216. Such price variations have recently been substantial even with the marketing order system in place. Kimmel Ex. 211, at 10. Demand for milk during the fall months now drives up Class I prices everywhere. Haldeman 11/2 Tr. at 216.

Finally, reconstituted milk would assure regions where shortfalls often occur a stable, certain and adequate source of supply. Williams 10/15 Tr. at 27. To meet demand during deficit periods, these regions now turn to costly imports of bulk milk. Sometimes, however, even these imports are uncertain. During the national proceeding, a witness from the Georgia Department of Agriculture testified that his state was unable to get enough milk at a reasonable distance three times in the recent past. Murphy 10/10 Tr. at 38. Although testifying against reconstituted milk, Mr. Murphy admitted that processors in his state have at times sought emergency authorization to reconstitute when they were short of milk. Id. at 40. Terminating the order system would remove artificial barriers to reconstitution of milk; uncertainty would be reduced by making reconstitution a routine response to short supplies that could be undertaken without the need to obtain regulatory permission.

2. Use of Reconstituted Milk Would Reduce Industry Costs And Lower Prices to Consumers

Increased use of reconstituted milk will lower transportation costs. At a minimum, some of the costly imports

of bulk milk from other states and areas will be replaced by imports of concentrated milk products, which are less expensive to transport. These cost savings likely will stimulate more imports of concentrated milk products into high-cost regions. Thus, milk produced in low-cost regions will displace some of the highest cost production. This will lower production and procurement costs in high-cost regions. Consumers will enjoy savings in two ways. They will be able to buy a less expensive fluid milk product, and the price of fresh fluid milk will drop as well.

Under market order regulation, handlers in high-cost regions now find it uneconomical to turn to reconstituted milk even when faced with deficits. Instead, they import bulk milk, often from distant parts of the country, and pay high transportation and "give-up" charges. Christ 11/2 Tr. at 155; Huber 9/6 Tr. at 58; Williams 9/10 Tr. at 130-131; see Williams 10/15 Tr. at 65.19/ If the order system is terminated, there will likely be increased use of reconstituted milk to supplement supplies, which will reduce transport costs currently incurred to import raw bulk milk. Shipping fluid concentrate rather than bulk milk

---

19/ A "give-up" charge is a payment made to the selling manufacturing plant for a spot purchase of milk.

could cut transportation costs in half because the concentrate will be reconstituted into two times as much fluid milk. Shipping powder, which is eleven times more compact than fluid milk, would save even more money.

The ability to ship product more cheaply would likely stimulate additional imports to satisfy local demand. In some cases, where local milk production costs are high, it would be cheaper to import concentrate or powder from other regions for reconstitution than to use local milk. This would lead to a gradual shift in dairy farming from high-cost regions to low-cost regions. Kimmel Ex. 211 at 19; see Hammond 11/16 Tr. at 42.

Full deregulation would not, however, cause reconstituted milk to "take over" local production. First, it is generally accepted that reconstituted milk would be mixed with local milk, often in equal amounts, before it is marketed. See Williams 9/10 Tr. at 196.20/ Even in the highly unlikely event that all the milk were sold as a reconstituted blend, only half of the local fresh milk would be displaced. On the other end of the spectrum, no local milk will be displaced if no one uses or buys

---

20/ It takes equal parts of whole fresh milk and milk reconstituted from nonfat dry milk powder (or concentrated skim milk) to produce 2% milk.

reconstituted milk. How much local milk is actually displaced, between none and half, would depend on consumer preferences and the price of reconstituted milk relative to that of local fresh milk.

Consumers are also apt to save money if reconstituted milk becomes available and Class I prices are not allowed artificially to restrain the market price of fresh milk. Where reconstituted milk is sold, it will likely be a lower-cost alternative or will cause the price of all milk to fall. If consumers have no preference between the two products, reconstituted and fresh milk would sell at the same price. Because the reconstituted milk was purchased more cheaply (it was likely imported from a lower-cost region with a lower Class I price), its price should drive down the price of fresh milk. Kimmel Ex. 211 at 19. In this case, all consumers, even those who do not choose to consume reconstituted milk, would save money.

3. Reconstituted Milk Is Likely To Provide Consumers With An Important Option

Whether removal of regulatory barriers to reconstituted milk will improve industry performance depends upon consumers' acceptance of reconstituted milk in the marketplace. While some have argued that allowing reconstituted milk would be futile because consumers would not purchase it, such assertions are not supported by the evidence. On the contrary, the record in the national proceeding is replete with evidence that some consumers

like the taste of reconstituted milk, and certainly do not reject the product, as critics have contended.21/ Most importantly, it should be recognized that the beneficial effects of allowing the sale of reconstituted milk do not turn on whether all consumers would be willing to switch to reconstituted milk at a lower price: It is sufficient if a not insignificant group of consumers would be willing to do so.

No one seeks to force people to buy reconstituted milk. As in the case of orange juice, fresh and reconstituted milk should be properly labelled and offered for sale without regulatory discrimination, so that consumers can choose what they like. If consumers do not like the taste of reconstituted milk, they simply will not buy the product, and the status quo -- relying on local supplies and imports of bulk milk from distant markets -- will be maintained.

21/ The results of taste tests summarized in a Report on the Consumer Preference Evaluation of Milk (Ex. 38), as well as other evidence, demonstrated that reconstituted low-fat blends made from dry milk powder substituted very well for fresh milk products, and "indicate[d] a large potential market for reconstituted milk, absent the current price restriction." Jesse 9/12 Tr. at 36-37. Many witnesses in the national proceeding also testified that milk reconstituted from reverse osmosis concentrates would enjoy consumer acceptance. E.g., Rittmueller 9/6 Tr. at 125; Nichols 9/10 Tr. at 38; see also, Dropik 9/20 Tr. at 99.

The real concern of those who oppose relaxation of restrictions on reconstituted milk is not that the industry will suffer if consumers do not like reconstituted milk, but that farmers in some areas might gain business at the expense of farmers in other areas by the displacement of some higher-cost fresh product by powder and fluid concentrates imported from low-cost production regions. Such reallocation may occur, as it has over time in many industries in our economy. To prevent the reallocation of society's scarce resources is costly and inefficient, harming in the long run both efficient producers and consumers.

4. Deregulated Milk Markets Have Been Successful

Experience in milk markets where deregulation has been tried suggests that deregulation produces benefits without adverse effects. The state of Wyoming terminated its state marketing order in early 1981. Kimmel Ex. 211 at 14. There is no evidence in the record that Wyoming has experienced problems as a result of deregulation, and it has saved, at the least, the cost of administering the regulatory program. South Carolina was also deregulated for a period of time. Its milk regulations were challenged in 1983, completely eliminated by 1985, and not replaced until 1990. Kimmel Ex. 211 at 14-15. The data suggest that deregulation led to increased sales of fresh fluid milk in

that market. Id. Per capita fluid sales rose by 12.3% from 156.8 pounds in 1983 to 176.1 pounds in 1988. Id. at 14-15.

In contrast, during this period of deregulation, per capita fluid sales were essentially constant both in the United States as a whole and in the only Federal milk marketing order bordering South Carolina, the Georgia Marketing Order. U.S. sales rose from 235.4 pounds in 1983 to 236.2 pounds in 1988 and Georgia marketing order sales rose from about 190.1 pounds in 1983 to 190.6 pounds in 1988.22/ Id.

CONCLUSION

Conditions affecting milk marketing are vastly different than they were when the marketing order program was established. These changed conditions indicate that the existing pervasive regulatory scheme not only fails to assure a healthy dairy industry with adequate supplies of fluid milk, but also imposes substantial costs on society.

The dairy industry, like virtually all other vital industries, should be freed from outdated and inefficient

---

22/ Milk prices have historically been relatively high in the South and in South Carolina, Kimmel Ex. 211 at 14, and therefore consumption has been relatively low there.

regulation. Reliance on the free market, including the unencumbered use of reconstituted milk, should result in more efficient production of the nation's milk supply and lower prices to consumers. Accordingly, USDA should move forward to eliminate the milk order system in favor of a free market system.

Respectfully submitted,

James F. Rill
Assistant Attorney General
Antitrust Division

Mark C. Schechter
Chief

J. Mark Gidley
Acting Deputy Assistant
Attorney General
Antitrust Division

Roger W. Fones
Assistant Chief

Janusz Ordover
Deputy Assistant
Attorney General
Antitrust Division

Susan L. Edelheit
Attorney

Janet R. Urban
Attorney
Transportation, Energy and
Agriculture Section
Antitrust Division

Department of Justice
555 4th St. N.W.
Washington, D.C. 20001
(202) 307-6349

March 6, 1992